The New York Times

How a Simple Tax Rule Let Donald Trump Turn a $916 Million Loss Into a Plus

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Oct. 3, 2016

It is among the least controversial parts of the federal tax code, almost as old as the income tax itself: A business, big or small, can escape taxation if it lost money in a previous year, a rule that helps businesses weather tough economic times, and hopefully thrive again.

But in the early 1990s, as his overleveraged and indebted properties faltered and he teetered on the edge of personal bankruptcy, Donald J. Trump sought to take this ordinary provision to an enormous scale and escape a foundering business — and avoid taxes for years going forward.

In 1995, according to documents published on Saturday by The New York Times, Mr. Trump claimed almost a billion dollars in operating losses that could be used to avoid future federal income taxation. The eye-popping figure would amount to almost 2 percent of all so-called net operating losses claimed by all American taxpayers that year.

The maneuver would have protected him for up to 18 years' worth of income taxes, easing his path to his new career: leveraging his name and knack for publicity while minimizing the risks to his fortune. Trump-branded apartment buildings, golf courses, men's wear and steaks were followed by his lucrative hit reality television series.

"I was able to use the tax laws in this country and my business acumen to dig out of the real estate mess," Mr. Trump said on Monday in a campaign appearance in Colorado. “Few others were able to do what I did.”

Because he has broken with decades of American political tradition and steadfastly refused to release any full personal income tax returns, much about what Mr. Trump did remains unclear. But the disclosure of his 1995 tax maneuver has led to a rare moment in which the arcana of tax policy turned into a national political issue.

And much like the admission by Mitt Romney in 2012 that he had paid an effective income tax rate of less than 14 percent in some years while amassing a $250 million fortune, the disclosure of Mr. Trump’s ambitious tax maneuver was seized on by Democrats as an illustration of the huge advantages tax rules can bestow on the wealthy.

More than 500,000 individual taxpayers took advantage of the same tax rule as Mr. Trump in 1995, according to the Internal Revenue Service. The average loss they claimed, however, was just $97,600. Mr. Trump’s $916 million loss accounted for almost 2 percent of the national total.

“He likes to say he does things in a big way, but I doubt he would boast about having what was likely the biggest net operating loss in the economy,” said Lily Batchelder, a law and public policy professor at New York University.

The rule that let Mr. Trump shelter almost $1 billion in income from taxation dates to 1918. It was enacted to prevent businesses from being penalized by the administrative convenience of calendar-year taxation: If a company loses $100,000 one year, and makes $100,000 the following year, the law allows the company to pay nothing in taxes, as it has only broken even.

There is nothing unusual about business losses appearing on a personal tax return. Most American businesses are organized as “pass-throughs,” rather than corporations, meaning their profits are passed through to their owners, and taxed as personal income. Losses are passed through, too.

"It's good policy," said Alan Cole, an economist at the conservative Tax Foundation. "This is just the astounding edge case that has everyone's eyes bulging as they look at that number."

But the rule also reflects an inequity in how income earned through labor is taxed compared with income earned through capital. Mere wage earners cannot avail themselves of the provision Mr. Trump and other business owners use to avoid taxes.

"As individuals, we generally don't get this," said David Herzig, a tax law professor at Valparaiso University School of Law in Indiana. "If you experience a loss in one year, you don't get to carry it forward or carry it back."

Ms. Batchelder said that it would be a boon to working families if they could carry over their deductions or spread out their taxable incomes over many years the way businesses do with their operating losses. "Virtually every taxpayer would be better off if they were able to pay tax on their average income rather than their income in a given year," said Ms. Batchelder, who was deputy director of the White House National Economic Council under President Obama.

It remains unclear exactly how Mr. Trump lost such a huge sum. But the rough outline of his business decline is well established. By the early 1990s, Mr. Trump had amassed hundreds of millions of dollars in personal financial liability and had lost money on casinos, his Plaza Hotel property in Manhattan and his airline, though precisely how he reflected those losses on his taxes is not known.

But the federal government has made it particularly easy for real estate investors to avoid taxes. Investors, for example, can walk away from a property and record the investment as a loss — even if they were playing with borrowed money. While a profit from that same property would be treated as a capital gain, losses are treated as "operating losses" under a tax code provision that dates back to the Great Depression. Those losses can be deployed far more flexibly than capital losses to shield other income from taxation.

“He was forced to sell many of his investments in the early 1990s, at pennies on the dollar, teetering on bankruptcy,” Edward Kleinbard, a tax expert at the University of Southern California, said of Mr. Trump. “There were real economic losses from those investments — borne entirely by the lenders. Yet nonetheless he was able to emerge with a large net operating loss to carry forward, attributable primarily to losing other people’s money.”

Mr. Trump has defended his tax maneuvers over the years not only as legal and appropriate, but as proof of his business acumen. But whether the government agreed with that assessment is an open question. A letter to Mr. Trump from his lawyers, which the campaign released in March, indicated that the government may have examined those claims, several tax lawyers said.

The letter said that an audit of Mr. Trump’s tax returns for 2002 through 2008 was “closed administratively by agreement with the I.R.S. without assessment or payment, on a net basis, of any deficiency.” That language suggests, the experts said, that the government may have reduced what Mr. Trump was able to claim as a loss without requiring him to pay any additional taxes.

The revelation that Mr. Trump could have avoided paying federal income taxes for 18 years is likely to thrust into the spotlight a tax provision that has received little attention from Congress for decades. Members of both parties have argued in recent years for new limits on the use of past losses to offset profits. Democrats have called for reducing the number of years such a shield can be used.

House Republicans have proposed a change that would prevent taxpayers from using past losses to avoid income taxes entirely.

Mr. Trump did not include that proposal in his own tax plan. He did propose a large tax cut for businesses, including real estate investment firms, although Mr. Trump has not clarified the size of those cuts. His campaign continues to publicize competing versions of the plan.

Alan Rappeport contributed reporting.

A version of this article appears in print on Oct. 4, 2016, on Page A16 of the New York edition with the headline: How a Simple Tax Rule Helped Trump Turn a Huge Loss Into a Plus